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The Law of Overdrafts

William O. Morris*

IT IS THE INTENT in this article to examine the judicial decisions in which the courts of this country have been called upon to resolve the rights and liabilities of parties involved with the issuance, payment, and receipt of overdrafts of both depositors and non-depositors of the payor bank.

All the cases examined antedate the adoption of the Uniform Commercial Code in the several jurisdictions. Rather than to consider the possible effect of the various provisions of Article 4 of the Uniform Commercial Code on the decisions in each of the cited cases, a separate portion of this paper is devoted to the applicable provisions of the Uniform Commercial Code which relate to the payment of checks by the payor bank. It will be noted that the Uniform Commercial Code basically codifies rules of law applied by the courts to overdrafts prior to the adoption of the Code.

Validity of Bank's Contract to Pay Overdrafts

At common law, and today in the absence of statute, it is within the power and authority of a bank to enter into an agreement with a bank customer to pay overdrafts which the customer may issue.¹ The holder of a check has been allowed to recover against the payor bank for the amount of an overdraft where the bank had entered into a contract with the drawer to pay his overdrafts. This was in effect a creditor beneficiary contract, and hence not an *ultra vires* contract on the part of the bank.²

However, in *S. R. & P. Import Co., Inc. v. American Union Bank*³ a New York court held that a bank has no right to subject its assets to liability for performance of a contract to cooperate with a customer of the bank in the use of overdrafts. Here the terms of the agreement between the bank and its customer permitted the customer to overdraw his accounts, and when the checks were presented for payment, the bank would not inform the payee of this fact until the close of the banking day. In denying recovery by the drawer against the payor bank the court did so on the basis of public policy. The court read into the statute, which made it unlawful to fraudulently issue checks, the idea that the legislature was opposed to the use of overdrafts in general. Both the decision and the opinion in this case leave much to be desired.

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¹ *Saylors v. State Bank*, 99 Kan. 515, 163 P. 454 (1917).

² *Ibid.*

³ 122 Misc. 798, 204 N.Y.Supp. 7 (1924).

Rights of the Holder of an Overdraft Against the Payor Bank

A payor bank is under no duty to the holder of a check to pay the sum which the drawer has on deposit with the bank when the amount on deposit in the drawer's account is either more or less than the amount of the check.⁴ A bank is not obligated to make partial payment of a check when the drawer's account is insufficient to pay the face amount of the instrument.

In one very old case it was held that if the payee of a check offers to accept from the bank the amount on deposit in the drawer's account, this being less than the face amount of the check, the payor bank is obligated to deliver the sum on deposit to the holder of the check. The court evidently treated the check as an assignment of the drawer's account to the holder of the check.⁵

When there are insufficient funds on credit to the drawer's account to cover a check, the payor bank may voluntarily pay the holder of the overdraft the amount which the drawer had deposited with it. This amounts to a partial payment of the check by the payor bank.⁶

*The Effect of the Payor Bank Crediting
Depositor's Account for an Overdraft*

By the great weight of authority a bank upon presentment of the check by its holder may reject and refuse to pay it so far as the payee is concerned, or credit the depositor's account conditionally.⁷ It has been held that when the payor bank unqualifiedly accepts the check and credits the account of the depositor for the amount of the check, the payor bank may not in the absence of fraud or collusion repudiate the transaction with the depositor.⁸ As between the bank and the depositor who presented the instrument to the payor bank, the bank must bear the loss in the event the check proves to be an overdraft.⁹ It is not necessary that the amount of the check be debited to the drawer's account or that the check be marked "paid" in order for the bank to be barred from collecting back the sum of the credit from the depositor. At this point one should examine that portion of this paper dealing with applicable sections of the Uniform Commercial Code. Attention is especially called to that portion of the discussion concerned with deferred posting.

⁴ Eads v. Commercial Natl. Bank, 33 Ariz. 499, 266 P. 14 (1928); Torrance Nat. Bank v. Enesco Fed. Credit Union, 134 Cal. App.2d 316, 285 P.2d 737 (1955).

⁵ Bromley v. Commercial Nat. Bank, 9 Phila. (Pa.) 522 (1869).

⁶ Dana v. Third Nat. Bank, 13 Allen 455 (Mass. 1866); Harrington v. First Nat. Bank, 85 Ill.App. 212 (1899).

⁷ Britton, Bills and Notes 500 (2d ed. 1961).

⁸ First Nat. Bank v. McKeen, 197 Ark. 1060, 127 S.W.2d 142 (1939).

⁹ *Ibid.*

The United States Supreme Court in *National Bank v. Burkhardt*¹⁰ cited with approval the following statement from Morse on *Banks and Banking*:

But if at the time the holder hands in the check he demands to have it placed to his credit, and is informed that it shall be done, or if he holds any other species of conversation which practically amounts to demanding and receiving a promise of a transfer of credit, as equivalent to an actual payment, the effect will be the same as if he had received his money in cash, and the bank's indebtedness to him for the amount will be equally fixed and irrevocable.¹¹

Whether or not there has been a consummated deposit amounting to final settlement between the depositor and the bank is a jury question.¹²

Perhaps one of the better cases involving the problem relating to the crediting of a depositor's account with the amount of an overdraft, both the drawer's and depositor's accounts being with the same bank, is *Bryan v. First National Bank of McKees Rocks*.¹³ The plaintiff-depositor brought an action, not on the check but in assumpsit, against the bank for the wrongful charging off on the bank's books a credit which the bank had given on its books in favor of the plaintiff-depositor. The court allowed recovery on the basis that the unconditional credit given to the depositor was equivalent to payment of the checks in cash followed by the deposit of this money in the depositor's account.

It is competent for the bank on which checks are both drawn and deposited to expressly agree that the payment of the checks shall be deferred for a reasonable time until the bank has had an opportunity to ascertain whether there are sufficient funds in the drawer's account to cover the check.¹⁴ If the parties can expressly agree that the credit given is conditional, they may tacitly do so under established custom well known to both.¹⁵

The written statement on the back of a check: "Credited to the account of Mrs. Icy Stephens 9/15/22, with the understanding that if not satisfactory to be made good", amounted to an agreement between the parties that the credit to the depositor's account of the amount of the check was conditioned and the bank could lawfully remove the credit.¹⁶

When a bank receives a check bearing an indorsement, other than one indicating that it was for collection, and the bank credits the amount

¹⁰ 100 U.S. 686, 689 (1879).

¹¹ 1 Morse, *Banks and Banking* § 321 (6th ed. 1928).

¹² *National Bank v. Burkhardt*, *supra* n. 10.

¹³ 205 Pa. 7, 54 A. 480 (1903).

¹⁴ *Pollack v. National Bank of Commerce*, 168 Mo.App. 368, 151 S.W. 774 (1912).

¹⁵ *Ibid.*

¹⁶ *Stephens v. First Nat. Bank*, 271 S.W. 395 (Tex.Civ.App. 1925).

of the check to the depositor's account the presumption formerly existed that the transaction constituted a sale of the check to the bank. This was a rebuttable presumption.¹⁷ Section 4-201 of the Uniform Commercial Code provides:

- (1) Unless a contrary intent clearly appears and prior to the time that a settlement given by a collecting bank for an item is or becomes final (subsection (3) of Section 4-211 and Sections 4-212 and 4-213) the bank is an agent or subagent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank such as those resulting from outstanding advances on the item and valid rights of set-off.

It is noted in the official comments to Section 4-201 that in the past much time had been spent and effort expended in trying to determine whether a bank in the collecting process was in fact a purchaser of the instrument or an agent. Under the language of Section 4-201 the presumption of agency is established "regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn." A contrary intent may rebut the established presumption but the evidence must be clear. An example showing a clear contrary intent would be if the collateral papers established or bore a legend stating that the item had in fact been sold to the depository bank.

The entry in the passbook is not a written contract within the parol evidence rule but is instead in the nature of a receipt and is prima facie evidence that the amount credited was in fact received by the bank, and the entries may be explained or contradicted. An entry in a passbook is no more than a receipt for the amount deposited and, like other receipts it is subject to explanation.¹⁸ Thus, when the depositor was informed at the time of the deposit that the check was drawn against insufficient funds and will be charged back if not made good, the bank may withdraw the credit even though it had been shown in the passbook, the bank not having debited the drawer's account nor credited the depositor's account.¹⁹

In two cases where the payee bank received through the mail for deposit checks drawn on the bank, it sent a notice of receipt of the checks to the depositor. In *City Nat. Bank v. Citizens' Bank*²⁰ the notice stated: "We credit your account . . . \$1000. . . . Checks and drafts on

¹⁷ *Stephens v. First Nat. Bank, id.*; *Downey v. National Exch. Bank*, 52 Ind.App. 672, 96 N.E. 403 (1911).

¹⁸ *Cooper v. Public Nat. Bank*, 208 App. Div. 430, 203 N.Y.Supp. 642 (1924).

¹⁹ *Black Mountain Bank v. Kelly*, 213 Ky. 34, 280 S.W. 461 (1926).

²⁰ 172 Ark. 624, 290 S.W. 48 (1927).

other points credited subject to payment." In the case of *Cohen v. First Nat. Bank*²¹ the notice provided: "We have entered to your credit \$3,567.50. All other items than those drawn on this Bank are credited subject to final payment."

The court in the *Cohen* case, in denying the bank the right to charge back the credit, held that when a check is passed to a bank for deposit and the bank credits the depositor's account, the relationship between the depositor and the bank becomes that of debtor-creditor since "the giving of credit under such circumstances is practically and legally the same as if the bank had paid the money to the depositor and had received it again on deposit. The transaction is thus complete and cannot be rescinded except for fraud or in case of mutual mistake."²² The court found that since the checks had been sent to the bank by mail that as a matter of law the transaction was closed whether or not the letter containing the notice and deposit slip actually reached the depositor. Here the credit was treated as actual payment of the check by the payor bank.

In the *City Nat. Bank* case the depositor was met with the defense that the drawer had no funds in the bank to pay the check and acceptance of the defendant was made under a mistake of fact. Here the plaintiff had received the check from the drawer in payment of an antecedent debt. The court decided that since the bank acted through a mistake of fact in making an acceptance it should not be bound by its acceptance unless the depositor should show some loss on account of its acceptance. The court reversed the holding in favor of the bank because of mistake on the part of the bank and held that the notice was not intended to be an absolute acceptance.

Payor Bank's Rights with Respect to Drawer of Overdrafts

One who overdraws his account is liable to the payor bank for the difference between the amount paid and the amount on deposit in the drawer's account.²³ When a payor bank pays or makes final settlement for an overdraft, it has made a loan to the drawer of the bank's assets.²⁴

The payor bank's right to recover the difference between the amount on deposit in the drawer's account and the amount paid from the draft is not defeated by the fact that the payor bank had previously certified the check,²⁵ nor is it impaired because an employee of the bank wrongfully fails to charge the account with the amount of the checks.²⁶ Sim-

²¹ 22 Ariz. 394, 198 P. 122 (1921).

²² *Ibid.*

²³ *Brackett v. Fulton Nat. Bank*, 80 Ga.App. 467, 56 S.E.2d 486 (1949); *Title Guarantee & Trust Co. v. Emadee Realty Corp.*, 136 Misc. 328, 240 N.Y.Supp. 36 (S.Ct. 1930); 1 Morse, *op. cit. supra* n. 11 at § 360.

²⁴ *Caddo Trust & Sav. Bank v. Bush*, 182 So. 397 (La.App. 1938).

²⁵ *Title Guarantee & Trust Co. v. Emadee Realty Corp.*, *supra* n. 23.

²⁶ *Mendota State Bank v. Riley*, 203 Minn. 409, 281 N.W. 767 (1938).

ilarly, the payor bank is not precluded from recovery from the drawer when it appears that the payor bank's employee fraudulently kept false books. In that instance a Missouri court allowed the bank to recover since the fraudulent practice of the bank's employee did not increase or decrease the amount of money the bank paid to the use of the defendant.²⁷

The same basic problem was present in *Bank of Proctorville v. West*²⁸ where a cashier of the payor bank instructed one to draw a check on his account for a certain amount assuring him that he, the cashier, would deposit the same amount in the drawer's account. The cashier failed to make the deposit but allowed the bank to pay the check. The oral agreement between the cashier and the defendant was unknown to the bank officers. The court granted recovery to the bank on the theory that the drawer had drawn the check and that he must suffer the misfortune of accepting the unauthorized assurance of the cashier.

The law clearly presumes a debtor-creditor relationship between depositor and the bank with respect to the amount on deposit in the depositor's account and a creditor-debtor relationship between the bank and the depositor for the amount which the bank pays out on an overdraft. Therefore, any general deposit which a depositor makes to his account which has been overdrawn will be presumed to have been made to pay the depositor's indebtedness to the bank which resulted from the payment of the overdraft, and the bank will be presumed to have received it in payment of the amount it paid over and above the amount which the drawer had on deposit with the bank.²⁹

The same rules of law apply where one draws a check on a bank where he has no account as where he issues an overdraft. If a bank pays a check drawn upon it by one who has no account with the bank, the bank may recover the amount paid from the party drawing the check.³⁰

*Payor Bank's Rights to Recover from Recipient Of
Payment of Overdraft Where Paid by Mistake*

The courts of this country have been almost unanimous in holding that the general rule of law that money paid under mistake of fact may be recovered back by the party making payment is not applicable to money paid by the payor bank to the holder of an overdraft. The courts usually give one or more of the following reasons for their refusal to allow the drawee bank to recover back from the holder the sum paid on an overdraft. Some courts have placed their decision upon ground that there is no privity between the bank and the recipient of payment

²⁷ Chew v. Ellingwood, 86 Mo. 260, 272 (1865).

²⁸ 184 N.C. 220, 114 S.E. 178 (1922).

²⁹ Nichols v. State, 46 Neb. 715 (1896).

³⁰ Dowd v. Stephenson, 105 N.C. 467, 10 S.E. 1101 (1890).

and, therefore, no right of recovery by the bank.³¹ Other courts have stated that it is the duty of a bank to know the state of its depositor's account, and if it makes a mistake, it must abide by the consequences.³² The bank always has the means of knowing the state of the depositor's account by an examination of its records. Other courts have adopted the view that the bank should not be permitted to repudiate its payment as this would destroy the certainty that must pertain to commercial transactions of this sort and that any other rule would result in uncertainty, delay, and annoyances which would follow if at some future time the payee of an overdraft was required to return the payment which he received from the payor bank in good faith.³³ There is really no legal reason to transfer from the bank, which paid an overdraft, to the innocent recipient of payment, the consequences of the bank's error.³⁴

In the absence of fraud practiced by the party receiving payment of an overdraft, the payment of a check by the bank is regarded as final.³⁵ A bank is always protected against fraud and imposition by the party with whom it dealt, but the bank is not to be protected from the folly of its own mistakes.³⁶

Morse in his works on *Banks and Banking* summarizes the problem very nicely in stating

If a bank pays or accepts under the misconception that it has funds, it cannot recover from the holder, it must look to the drawer alone for redress. But under the clearing-house rules a check paid through the clearing may be returned within a certain time, if the funds are found insufficient.³⁷

Where the bank is able to show that payment had been fraudulently obtained or that the holder received payment from the payor bank of a check knowing it to be an overdraft, the bank may recover back the sum paid where the facts are not recognized by the bank.³⁸

The Illinois court has permitted a bank which paid an overdraft to recover back the sum paid to the holder where the bank was mistaken as to the condition of the drawer's account and the bank had credited

³¹ *Citizens' Bank v. Schwarzschild & Sulzberger Co.*, 109 Va. 539, 64 S.E. 954 (1909).

³² *Manufacturers' Nat. Bank v. Swift*, 70 Md. 515, 17 A. 336 (1889); *Oddie v. National City Bank*, 45 N.Y. 735 (1871).

³³ *Liberty Trust Co. v. Haggerty*, 92 N.J.E. 609, 113 A. 596 (1921); *Citizens' Bank v. Schwarzschild & Sulzberger Co.*, *supra* n. 31.

³⁴ *Penacook Savings Bank v. Hubbard*, 58 N.H. 167 (1877).

³⁵ *Manufacturers' Nat. Bank v. Swift*, *supra* n. 32.

³⁶ *Bank v. Hull*, Dud. 259 (S.C.)

³⁷ 2 Morse, *op. cit. supra* n. 11, § 455.

³⁸ *Iowa State Bank v. Cereal Refund & Brokerage Co.*, 132 Iowa 248, 109 N.W. 719 (1906); *Tradesman's Bank v. Merritt*, 1 Paige (N.Y. 1829); *Peterson v. Union Nat. Bank*, 52 Pa. 206 (1866); *Bankers' Trust Co. v. United States Register Co.*, 200 Iowa 1014, 205 N.W. 838 (1925); *National City Bank v. Titlow*, 233 F. 838 (D.C. 1916); *Marie Antoinette Realty Co. v. Yorkville Bank*, 122 Misc. 522, 205 N.Y.S. 395 (1924).

the drawer's account twice for the same deposit. The bank had in fact paid out money under mistake of fact.³⁹

*Payor Bank's Right to Recover Interest from
Drawer for Amount Paid by Bank on Overdraft*

Each overdraft paid by the payor bank immediately creates liability on the drawer of the draft to reimburse the payor bank for the amount expended by the payor bank to cover the drawer's overdraft.⁴⁰ However, in the absence of an agreement between the payor bank and the drawer of an overdraft, the bank is without right to demand from the drawer interest on the amount paid by the payor bank in excess of the sum which the drawer had on deposit with the payor bank.⁴¹ Even though the payor bank under such circumstances is deemed to have made a loan to the drawer to the extent of the overdraft in the absence of a statute so providing or an agreement between the parties, an ordinary loan of money does not carry with it an implied promise on the part of the borrower to pay interest on the amount borrowed.

Money which has been wrongfully or fraudulently obtained from a bank bears interest at the legal rate.⁴² Inducing a bank to pay an overdraft is not necessarily wrongful. The overdraft may have been issued and paid as the result of an understanding between the payor bank and the drawer. Payment made by the payor bank of an overdraft constitutes a loan by the bank to the drawer.⁴³ In absence of an agreement from the outset, the obligation of the drawer does not carry with it an obligation to pay interest on this sum until there has been a refusal on the part of the drawer-debtor to repay the bank, after due demand, or some other default by the drawer-debtor.⁴⁴

When there is a loan without any stipulation to pay interest, and when one has the money of another, having been guilty of no wrong in obtaining it, and no default in retaining it, interest is not chargeable.⁴⁵

However, where there is an agreement on the part of the drawer to pay the payor bank interest on the amount owed on the overdraft, and no rate has been agreed upon, the payor bank is entitled to collect interest at the statutory legal rate.⁴⁶

³⁹ McLean County Bank v. Mitchell, 88 Ill. 52 (1878); Bank of Benson v. Swanson, 107 Neb. 687, 187 N.W. 88 (1922).

⁴⁰ Brown v. Mutual Trust Co., 267 Pa. 523, 110 A. 155 (1920).

⁴¹ Owen v. Stopp, 32 Ill. App. 653, 656 (1889).

⁴² Wood v. Robbins, 11 Mass. 504 (1814).

⁴³ Hubbard v. Charleston Branch R.R. Co., 52 Mass. 124 (1846).

⁴⁴ *Id.* at 128.

⁴⁵ *Ibid.*

⁴⁶ Loan & Exch. Bank v. Miller, 39 S.C. 175, 17 S.E. 592 (1893).

An overdraft permitted by the payor bank is a loan to the drawer due on demand and as with open accounts generally does not carry interest.⁴⁷ However, when demand has been made or an account has been rendered, interest will start to accrue.⁴⁸ A note given by the drawer to the payor bank to cover an overdraft was held to carry interest in the absence of an agreement otherwise from the date of delivery.⁴⁹ On the other hand, a Texas court intimated that the bank's claim against the drawer of a paid overdraft was a liquidated demand and the drawer under certain circumstances might be obligated to pay interest to the payor bank from the accrual of the indebtedness. The court appeared to allow recovery of interest from the date the bank unsuccessfully demanded payment and charged the account of the drawer with the overdraft.⁵⁰

In *Cohen v. Marian*⁵¹ the facts disclosed that the signature card which the bank had its depositor sign when opening an account listed a schedule of normal banking charges. For the benefit of a depositor, the bank followed a course of conduct and rendered services to the customer which were not scheduled on the signature card. The bank permitted the depositor to make covering deposits against checks drawn by him against insufficient funds. The court ruled that the payor bank could charge the drawer for the extra services and approved a charge of twenty-five cents per one hundred dollars of overdraft on the basis that there was an implied contractual obligation on the part of the drawer to pay a reasonable charge or fee to the payor bank for the extraordinary service.

*Payor Bank's Responsibility When Several Checks Are
Presented at the Same Time and Drawer's Account Is
Insufficient to Pay All*

There is no doubt that a bank is under a duty to pay checks drawn on it in the order in which they are presented for payment.⁵² No check holder has the right to demand that his check receive priority in payment over a check presented for payment at an earlier date.⁵³ A problem for the payor arises when several checks are presented for payment at the same time and there are insufficient funds available in the drawer's account to pay all the checks. The crux of the payor bank's problem is which check or checks should or must be paid when all the checks in

⁴⁷ *Hennessy Bros. & Evans Co. v. Memphis Nat. Bank*, 129 F. 557 (6th Cir. 1904); *Thomas v. International Bank*, 46 Ill.App. 461 (1891).

⁴⁸ *Casey v. Carver*, 42 Ill. 225 (1866).

⁴⁹ *Preston State Bank v. Finberg*, 305 S.W.2d 654 (Tex.Civ.App. 1957).

⁵⁰ *Loan & Exch. Bank v. Miller*, *supra* n. 46.

⁵¹ 171 Pa. Super 431, 90 A.2d 373 (1952).

⁵² *First Nat. Bank v. McKeen*, *supra* n. 8.

⁵³ *Ibid.*

question were received simultaneously, either through the mail or a clearing house.

Chief Judge Green in *Louisville & N. R. Co. v. Federal Reserve Bank*⁵⁴ took the position that “[w]hen a bundle of checks is presented through a clearing house, all must be paid or none. The payor bank is not entitled to select checks for payment, if funds to pay all are insufficient.”⁵⁵ Judge Green cited as authority for his statement the following passage from Morse on *Banks and Banking*:

The payment of checks may be affected by the use of the clearing house in one important particular. Checks, as has been seen, must be paid in the order of presentment. But when the deputy of the bank takes from its drawer in the clearing house all the checks which it has to pay, he may receive a considerable number of checks of the same depositor. It is clear that there can be no priority among these. They are all received at precisely the same moment. For the order in which they are placed in the drawer has nothing to do with the presentment of them to or receipt of them by the bank, indeed is in nearly all cases unknown to the bank. The bank cannot look at their dates; for priority of presentment, not of date, secures priority of payment. So if the bank cannot pay all the checks of any individual depositor then coming through clearing, it must pay none of them. It has no legal power or right to select or choose from among them certain ones which it will honor, or certain ones which it will dishonor. All or none must be paid. Any other course would render the bank liable to the holders of the dishonored paper. A check presented at the counter for payment must be paid at once, if there are funds enough to the drawer's credit to pay it alone; but if it is sent through clearing it must take its chance that his funds shall be sufficient to pay not only it, but all his other checks which shall be sent through clearing the same day; and failing this, it must be dishonored.⁵⁶

A Pennsylvania court in *Reinisch v. Consolidated Nat. Bank*⁵⁷ refused to accept as law the aforementioned quoted statement of Morse. The court adopted not only a more practical solution but also a more sound rationale. In the *Reinisch* case the drawer of several checks sued the payor bank in an action in trespass to recover damages from the payor bank resulting from the bank's failure to pay his checks. The plaintiff based his claim on the violation of a duty arising out of the contract of deposit. The appellate court affirmed the holding of the lower court and allowed the plaintiff to recover damages since it was shown that the depositor had sufficient funds on deposit to pay part of the checks which reached the bank at the same time but not enough to cover all of them. The court recognized that the drawee could have

⁵⁴ 157 Tenn. 497, 10 S.W.2d 683 (1928).

⁵⁵ *Louisville v. Federal Reserve Bank*, *supra* n. 54.

⁵⁶ 1 Morse, *op. cit. supra* n. 11 at § 354.

⁵⁷ 205 Pa. 7, 54 A. 480 (1903).

determined for itself which checks it would pay by selecting some uniform method such as the order of their dates or the order of their amounts. The court said: "After allowing to the bank every reasonable discretion in the way of selecting which checks it would pay, this obligation demanded of it that it should select and pay some of them until the plaintiffs' deposit was exhausted."⁵⁸ The court reasoned that since the check does not constitute assignment of the drawer's funds, the holder of a check may not maintain an action on the check against the payor bank for there is no contractual relationship between the holder of a check and the payor bank. It necessarily and logically follows that the holder may not maintain an action against the payor bank for refusing to pay a check because of insufficient funds on deposit in the drawer's account because in the absence of certification or acceptance there is no legal relationship between the holder of a check and the payor bank from which a duty from the bank to the holder of the check may be implied.

The view expressed by the Pennsylvania court has been accepted in several jurisdictions. A Massachusetts court ruled that the bank could pay the checks in whatever order it decides until there are no longer sufficient deposits to pay any of them. Otherwise the credit standing of the depositor might be seriously damaged.⁵⁹ In adhering to this rule the courts have held that the unfortunate holders of checks which are not paid due to lack of sufficient funds to pay all checks drawn on the account have no cause of action against the payor bank because the payor bank elected to pay checks belonging to other persons.⁶⁰

*Rights of Payor Bank When Drawer Maintains Two
Accounts in Bank and One Account Is Overdrawn*

It has been held that when a customer of a bank overdraws his checking account the payor bank may set off against the drawer's savings account the amount due it on the overdraft.⁶¹ The relationship of debtor-creditor exists between the bank and its depositor both with respect to a checking and savings accounts maintained with the bank.⁶² As the drawer of an overdraft is indebted to the payor bank which pays his overdraft to the extent that the drawer's account is overdrawn the bank may set off the sum due it from its customer against any sum the customer has on deposit with the bank in a savings account.⁶³ While no cases have been found so holding it would seem to follow that a

⁵⁸ Pollack v. National Bank of Commerce, 168 Mo. App. 368, 151 S.W. 774 (1912).

⁵⁹ Castaline v. Nat. City Bank, 244 Mass. 416, 138 N.E. 398 (1923).

⁶⁰ Chadd v. Byers State Bank, 111 Kan. 279, 206 P. 880 (1922).

⁶¹ Pursiful v. First State Bank, 251 Ky. 498, 65 S.W.2d 462 (1933).

⁶² *Ibid.*

⁶³ *Id.*

bank may in the first instance debit the drawer's savings account in order to pay a check when the drawer is without sufficient funds in his checking account to cover a check.

However, if the drawer of a check specifies that it is to be paid by the payor bank only from funds on deposit in a checking account maintained by the drawer, it logically follows that the payor bank may not properly debit any other account, checking or savings, maintained by the drawer with the payor bank for an overdraft issued by the depositor. Where a depositor has two checking accounts with the payor bank which are kept separate merely for the convenience of the customer, such as for bookkeeping reasons, when an overdraft is presented to it for payment the payor bank is justified in assuming that the drawer intended the check to be protected by the other account, and the bank may debit the second account to the extent necessary to cover the overdraft.⁶⁴

Overdrafts Issued by an Agent

Authorities are almost unanimous in holding that an agent has no implied authority to borrow money on the credit of his principal in the absence of express authority where the principal has charged the agent with the performance of duties which necessarily require him to do so.⁶⁵ It has been said that the power of an agent to borrow money on the credit of his principal "may have such grave consequences for the principal that it will be inferred only when indispensable in accomplishing the purpose of the agency."⁶⁶

The payment of an overdraft by a bank in reality involves the extension of credit by the bank. The question as to whom the credit was in fact given is crucial in determining from whom the payor bank which pays an overdraft may recover the sum due it resulting from the payment of the overdraft.

A power of attorney given to an agent to draw checks on the principal's account is not authorization to the agent to obligate his principal for the debt created by the payment of the overdraft drawn by an agent on his principal's checking account. In such a case the bank was denied the right to recover from the principal the overdraft issued by an agent. The payor bank would be limited to the recovery from the agent of the sum due on the overdraft.⁶⁷

Where an agent opens a checking account in the name of his principal, as he did in *Case v. Hammond Packing Co.*⁶⁸ without the authority

⁶⁴ *Hillir v. Bank of Columbia*, 92 S.C. 445, 75 S.E. 789 (1912).

⁶⁵ *Citizens' State Bank v. Minnesota Sugar Co.*, 163 Minn. 378, 204 N.W. 45 (1925).

⁶⁶ *Ibid.*

⁶⁷ *The Union Bank v. Mott*, 27 N.Y. 633 (1863).

⁶⁸ 105 Mo.App. 168, 79 S.W. 732 (1904).

of the packing company, the account is the agent's account and not his principal's. In the *Hammond Packing Co.* case the payor bank was denied the right of recovery from the so-called principal for the indebtedness resulting from the payment of the overdraft even though the principal was the recipient of payment of the overdraft. The principal was unaware of the overdraft when it received payment and therefore did not ratify the agent's act.

Likewise in *Haskins v. Anderson*⁶⁹ the Pennsylvania court denied the bank the right to recover from a principal the amount of an overdraft issued by an agent on a bank account which he had opened in the principal's name since it was not shown that the authority of the agent extended beyond that of a mere purchaser for his principal's account.⁷⁰

Where an agent opens an account in his own name, without authority of his principal either express or implied, and then overdraws the account, the principal is not obligated to make good the overdraft to the bank. The bank extended credit to the agent and can look only to the agent for payment.⁷¹

A novel set of facts was present in *Long Bell Lumber Co. v. First National Bank of Drumright*.⁷² Although the statement of facts is not as clear as it might have been, it appears that the lumber company had an account on which the manager and agent of the company issued a check to the lumber company when there were insufficient funds in the account to cover the check. The agent had promised the bank to complete certain arrangements to get funds to cover the check in question. The bank paid the check which was an overdraft, but the manager did not deposit money in the account to cover the overdraft. The bank was denied the right to recover from the principal to the extent of the overdraft. The court found that the bank had simply made a loan to the agent to enable the agent to settle with the principal since the bank was aware of all the facts at the time it paid the overdraft.

Where a principal pays the bank for overdrafts drawn by an agent over a period of several years it is estopped to question the authority of the agent to draw the overdrafts, and the bank may recover the sum of unpaid overdrafts from the principal.⁷³

⁶⁹ 284 Pa. 485, 131 A. 272 (1925).

⁷⁰ *Ibid*; see also *Citizens State Bank v. Western Union*, 134 C.A.2d 327, 172 F.2d 950 (1949).

⁷¹ *Citizens' State Bank v. Minnesota Sugar Co.*, *supra* n. 65.

⁷² 95 A.D.C. 266, 1 F.2d 127 (1924).

⁷³ *Merchants' & Planters' Nat. Bank v. Clifton Mfg. Co.*, 56 S.C. 320, 33 S.E. 750 (1899).

*Overdrafts Issued by
a Partnership*

The payor bank may recover from the individual members of a partnership the sum due the payor bank on a partnership overdraft even though the overdraft was in fact issued in satisfaction of a personal debt of a partner.⁷⁴ Where, however, the payor bank was informed by one of the partners that he would no longer be responsible for subsequent overdrafts of the firm, the bank's right of recovery on any overdraft thereafter paid would be limited to recovering from the non-protesting partner or partners.⁷⁵

Moreover, the payor bank may not set off against an account of an individual partner the sum owed by the partnership for overdrafts issued by the partnership.⁷⁶ In this instance, no lien is created against the personal accounts of the members of the partnership. This is not to say, however, that the payor bank could not in a proper action recover from the partners the amount owed by the partnership to the bank. In such instance the bank has the right to institute an independent action or to plead the amount due to it as the result of payment of the overdraft as a counterclaim. In *Adams v. First Nat. Bank*,⁷⁷ the bank pleaded the general issue instead of filing a counterclaim for the amount due. The court held that although the bank could properly institute an independent action or file a counterclaim to the suit at bar, the plea of general issue did not entitle the bank to judgment in the amount due it on the overdraft.

*Overdrafts Deposited In One Branch When Drawer
Maintained Account in Different Branch
of Same Bank*

There has been surprisingly little litigation with respect to overdrafts paid or credit given to the account of a depositor on an overdraft when the depositor and the drawer maintain an account with different branches of the same bank.

The only case discovered in which the question of settlement between a depositor and a branch of the payor bank is *Balsam v. Mutual Alliance Nat. Trust Co.*⁷⁸ The court inferred that a check was in fact paid when it was received by the bank at one of its branches and the passbook of the depositor was credited and the check marked "Paid."

In the *Balsam* case the court determined that an indorser of a check who had deposited it in a branch office of the defendant-payor bank, and

⁷⁴ *Morris v. First Nat. Bank*, 162 Ala. 301, 50 So. 137 (1909).

⁷⁵ *Bank of Bellbuckle v. Mason*, 139 Tenn. 659, 202 S.W. 931 (1918).

⁷⁶ *Adams v. First Nat. Bank*, 113 N.C. 332, 18 S.E. 513 (1893).

⁷⁷ *Ibid.*

⁷⁸ 74 Misc. 465, 132 N.Y.Supp. 325 (S.Ct. 1911).

the amount of the check had been credited to the depositor's passbook, and the check had been marked "Paid," could not recover from the bank. The plaintiff-indorser had taken up the check from his indorsee, the depositor in the bank, because the bank discovered the drawer's account was without sufficient funds to pay the check. The indorsee-depositor did not assign to the plaintiff any rights which the depositor might have had against the payor bank. Any cause of action against the bank rested in the depositor on the basis of a debtor-creditor relation having been created by the act of the bank in giving credit for the check and not in the plaintiff-indorser who took up the check. As a side light there is a definite question as to whether the plaintiff in this case was under any obligation to reimburse the indorsee for the overdraft. It would seem that he had been discharged from liability by the act of the bank in settling for the check deposited.

*Finality of Payment under Provisions of
Uniform Commercial Code*

Prior to the adoption of the Uniform Commercial Code there was no complete, systematic body of statutory law in any state governing the bank deposits and collections.⁷⁹ The section of the Code dealing with this problem is perhaps the most complex area of the Uniform Commercial Code. In an article entitled *A Battle with Complexity*,⁸⁰ the author stated:

Judging by the end product of Article 4 and the Comments to the Article, the general approach adopted in drafting the article was something as follows. The movement of perhaps 25,000,000 items through bank channels every business day was a volume operation of tremendous proportions. Such operation was primarily mechanical and the rules governing it similarly should be largely mechanical.⁸¹

The area of final payment, though mechanical, is as complex as this author implies.

The instant in time that a settlement between a depositor and the payor bank occurs must be determined with accuracy, because it is at this point in time that the drawer loses the power to order the payor to stop payment of the check; it is at this point in time that the loss in the event of the insolvency of the drawee-payor shifts from the drawer to the party who deposited the check for credit in the payor bank; it is from this point in time that a creditor of the drawer may no longer reach the amount debited to cover the check; and lastly it is the point in time when

⁷⁹ Study of the Uniform Commercial Code 365 (N. J. 1960).

⁸⁰ Malcolm, *A Battle With Complexity*, 37 Wis. L. Rev. 265 (1952).

⁸¹ *Id.* at 270.

the bank can no longer set off any claim which it might have against the fund for an amount owed to the bank by the issuer of the check.⁸²

Where a payor bank gives cash for an instrument presented over the counter for payment or makes final settlement with the person who presented the check for credit to his account, the payor bank is normally without remedy against anyone, other than the drawer of the instrument, should it be determined that the drawer's account was insufficient to cover the instrument.

Section 4-213 of the Code provides:

- (1) An item is finally paid by the payor bank when the bank has done any of the following, whichever happens first:
 - (a) paid the item in cash; or
 - (b) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; or
 - (c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or
 - (d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

Upon a final payment under subparagraphs (b), (c), or (d), the payor bank shall be accountable for the amount of the item.

The term "payor bank," as defined in 4-105 (b) of the Code, is "a bank by which an item is payable as drawn or accepted." Subsection 1(a) of section 4-213 clearly states that once the payor bank has in fact paid the instrument in cash it cannot revoke its payment. This is in accord with the law prior to the adoption of the Code.

Subsection 1(b) recognizes that the payor bank has no right to withdraw from the depositor's account credit extended to the depositor's account in the absence of an agreement between the payor bank and the depositor or unless the payor bank acts in accordance with the provisions of the Code relating to deferred posting.

Subsection 1(c) fixes in clear and concise language the point at which the payor's posting process is in fact deemed to have been finally settled. Debiting the account of the drawer of a check for the amount of the check amounts to a final settlement on the part of the payor bank so far as fixing the rights of the respective parties to the transaction and terminates the payor bank's right to charge back to the account of the depositor any credit given with relation to the instrument in question.

⁸² It should be noted that we are not here concerned with any action which the payor bank may have against the drawer or any party subsequent to the drawer resulting from fraud or breach of warranty. The concern is the recovery of money loaned by the bank on overdrafts. This article is only incidentally concerned with checks presented to the payor bank through a clearing house.

Subsection 1(d) authorizes provisional settlement for an item which may become final upon the lapse of the period of revocability as permitted by the terms of the provisional settlement, by statute or clearing house rules.

With respect to the rights of the payor bank to charge back against the account of the depositor the amount of a credit given on an overdraft, attention must be directed to subsections 3, 4 and 5 of 4-212 of the Code. These subsections provide:

- (3) A depository bank which is also the payor may charge back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by the payor bank for credit on its books (Section 4-301).
- (4) The right to charge-back is not affected by
 - (a) prior use of the credit given for the item; or
 - (b) failure by any bank to exercise ordinary care with respect to the item but any bank so failing remains liable.
 - (c) A failure to charge-back or claim refund does not affect other rights of the bank against the customer or any other party.

In order to fully appreciate the problems resolved by 4-212 of the Code, one must not lose sight of the provisions of 4-301 of the Code wherein it is stated:

- (1) Where an authorized settlement for a demand item (other than a documentary draft) received by a payor bank otherwise than for immediate payment over the counter has been made before midnight of the banking day of receipt the payor bank may revoke settlement and recover any payment if before it made final payment (subsection (1) of section 4-213) and before its midnight deadline it
 - (a) returns the item; or
 - (b) sends written notice of dishonor or nonpayment if the item is held for protest or is otherwise unavailable for return.
- (2) If a demand is received by a payor bank for credit on its books it may return such item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in the preceding subsection.

Section 4-301 of the Code empowers the payor bank to revoke or charge back against the depositor's account a credit given to the depositor's account prior to "final payment." The payor bank's right is limited in time to the bank's "midnight deadline." A bank's midnight deadline is defined in 4-104 (h) as being "midnight the day following the banking day on which the bank received the item." It is clear that there is written into the deferred posting authorization of 4-301 of the Code the right on the part of the payor bank to revoke the credit given to the bank's

depositor in the event the account of the drawer of the check had insufficient funds on deposit to cover the check, provided the payor bank acts timely. This affords the payor bank a period in which to complete its posting and to determine the state and the condition of the drawer's account. Should it be determined that the funds in the drawer's account are insufficient to cover the check or that the drawer did not in fact have an account, the bank may then cancel the credit given to the depositor's account. The payor bank does not lose its right to charge back against the depositor's account the credit given for an overdraft merely because the depositor may have withdrawn from his account the sum credited for the overdraft by the payor bank.

With respect to deferred posting, the drafters of the Code proceeded on the theory that the payor bank in giving credit to the account of the depositor has in effect paid the instrument, but the sum "paid" may be recovered by the payor bank within the prescribed statutory period. The drafters of the Model Act of the American Bankers Association proceeded on the theory that there was no "payment" until the expiration of the specified period after the credit had in fact been given.⁸³

Mr. Malcolm, in his article entitled *A Battle with Complexity*, stated with respect to the time a bank is deemed to have made final settlement:

In this process in the regular flow of operations for all items except those specially handled, the key point . . . is when the bookkeeper for the drawer's account determines or verifies that the check is in good form and that there are sufficient funds in the drawer's account to cover it.⁸⁴

Perhaps it would not be amiss, at this point, to call attention to section 4-106 of the Uniform Commercial Code which provides

A branch or separate office of a bank [maintaining its own deposit ledgers] is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders shall be given under this Article.⁸⁵

In *Anderson's Uniform Commercial Code* the author writes at § 4-106-5

Under the Code a branch or separate office of a bank is not treated as an independent or separate branch for all purposes. The specification of Code § 4-106 that a branch or separate office is a separate bank accords the separate bank status only for the purpose of computing the time within which or determining the place at or to which action may be taken or notices or orders shall be given.

⁸³ Leary, *Deferred Posting and Delayed Returns*, 62 Harv. L. Rev. 905, 930 (1949).

⁸⁴ Malcolm, *op. cit. supra* n. 80 at 293.

⁸⁵ The brackets are to make it optional with the several states whether to require a branch to maintain its own deposit ledger in order to be considered to be a separate bank for certain purposes under Article 4. In some states "maintaining its own deposit ledgers" is a satisfactory test. In others branch banking practices are such that this test would not be suitable.

A branch or separate office is also to be regarded as a separate bank with respect to the operation of a stop payment order, and the acquisition of such notice as prevents the branch from becoming a holder in due course.

If a branch is in fact considered to be a separate bank under accepted operating standards, then it might be argued that the bank has not made final settlement of an overdraft until a check has in fact reached the branch in which the drawer maintains his account or on which the check was drawn. This seems to be the more logical approach to the problem of determining when there has been payment of a check or final settlement made.

Conclusion

By the way of conclusion, it may be observed that the laws applicable to overdrafts have not been changed or altered to any great extent by the adoption of the Uniform Commercial Code. For the most part good case law prior to the adoption of the Code remains good law after its adoption.

It is suggested that banks re-examine the form of the agreement used when a customer opens an account with the bank, with the view to updating the contract to cover problems which may result from the adoption of the Uniform Commercial Code in the particular jurisdiction. It would seem clear that there should be a provision authorizing a bank to charge interest on overdrafts paid.